

April 9, 2018

The Honorable Al Muratsuchi, Chairman  
Joint Legislative Audit Committee  
1020 N Street, Room 107  
Sacramento, California 95814

**RE: Local Government High Risk Audit Program – City of Montebello**

Dear Chairman Muratsuchi:

Government Code section 8546.10 permits the California State Auditor (State Auditor) to develop a high-risk local government agency audit program for the purpose of identifying, auditing, and issuing reports on any local government agency, including a city, county, special district, or other publicly created entity, that the State Auditor identifies as being at high risk for the potential of waste, fraud, abuse, and mismanagement or that has major challenges associated with its economy, efficiency, or effectiveness. Pursuant to this provision, I plan to present for the committee's review and approval a proposal to audit the city of Montebello.

Incorporated in the 1920s, Montebello is located in southeast Los Angeles County and has a population of about 64,000. Montebello had general fund revenues of \$40 million in fiscal year 2016–17. Approximately 60 percent of Montebello's revenue in that year came from property taxes, sales taxes, and charges for services. Nearly two-thirds of Montebello's government expenditures support public safety, which includes both police and fire services. Finally, Montebello operates several business-type activities, the largest of which is a bus system with a network that serves numerous surrounding communities. Other activities include a small water district, a golf course, a detention facility, and two hotels, one of which is under construction.

Two of Montebello's business-type activities together had operating deficits in fiscal year 2016–17. The city's general fund subsidized the golf course's deficit in 2016-17, as well as the detention center's deficit. The failure of these business-type activities to support themselves represents an obstacle to the city's ability to stabilize its finances. In some cases the city has drawn on its general fund to address the deficits, which reduces funding available for other essential city services.

In 2011 the State Controller's Office (SCO) conducted four separate audits into various aspects of the city's operations and in one audit found that only 11 percent of the internal controls that the SCO reviewed were adequate. The SCO concluded that some of Montebello's internal control deficiencies might have contributed to the city's poor financial condition at that time. The SCO also raised concerns over the city's competitive bidding practices, citing an engineering contract the city continued to extend beyond the limit established in a city ordinance.

Finally, the city's general fund continues to be weak. It benefitted from a one-time transfer of \$4.7 million in restricted funds in fiscal year 2016-17, and the city's budget for fiscal year 2017-18 projects the city's general fund reserves will fall \$3 million by the end of 2017-18. In May 2017, the city council declared a fiscal emergency, froze hiring for full-time employees, and placed a sales tax measure on the November 2017 ballot. That measure failed.

An audit of the city of Montebello would determine whether the city has effective internal controls in place to protect city funds and assess whether Montebello uses its funds in the best interests of the city's residents. The proposed audit will address the following:

1. What are Montebello's plans for addressing deficits in its transit system, water utility, and golf course? Will Montebello be able to avoid using general fund dollars to support these programs in the future?
2. What are Montebello's plans for addressing infrastructure needs related to its water utility?
3. Are the revenue projections for Montebello's hotels reasonable estimates of future revenue? What are Montebello's plans for using those projections when developing future budgets?
4. Does Montebello's financial condition affect its ability to pay its obligations when due?
5. What corrective actions has Montebello taken in response to the recommendations in the SCO's 2011 reviews?
6. Does Montebello comply with procurement policies and best practices for ensuring it receives the best value for the goods and services it purchases?

If you have any questions regarding this audit proposal, please contact me or Paul Navarro, Chief Deputy Director of Operations, at (916) 445-0255.

Sincerely,



ELAINE M. HOWLE, CPA  
California State Auditor